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DETERMINANTS OF CONSERVATIVE AND AGGRESSIVE WORKING CAPITAL INVESTMENT AND FINANCING POLICIES: EVIDENCE FROM THE PUBLIC LISTED COMPANIES IN MALAYSIA

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ABSTRACT

Working capital management is related to the operating activities of a company and therefore is one of the most significant decisions that managers need to make. However, studies on this area are still dearth relative to the studies on long-term financing decision of a company. Inappropriate working capital management investment and financing policies have implication on companies' profitability, risk and sustainability. Working capital management policy involves being conservative or aggressive using current assets (investment) and current liabilities (financing) towards total assets. The extent to which Malaysian companies listed at Bursa Malaysia adopted conservative and aggressive working capital investment and financing policies remains blurred. Thus, the objectives of this research are two folds, which are, firstly to examine the determinants of conservative and aggressive working capital investment and secondly to investigate the determinants of conservative and aggressive financing policies. Panel data regression analyses are conducted on Malaysian public listed companies for seven sectors mainly industrial, trading and services, consumer, properties, construction, plantation and technology. The duration of the study starts from 2001 until 2017. Empirical evidences for the first objective reveal that the decisions to follow conservative or aggressive working capital investment policies vary from one sector to another due to the nature of business they are in. No significant factors seem to influence conservative working capital investment policy (CWCIP) for construction sector, while all identified factors have influenced on CWCIP for industrial, trading and services and consumer sectors. Factors affecting the CWCIP of plantation sector are AGE, FCF and SIZE while for property sector; the policy decision is driven by FCF, LEV and SIZE. Finally, only PROF determinant affected the CWCIP for technology sector. In terms of aggressive working capital investment policy (AWCIP) determinants, for property sector, only LEV is not the determinant for AWCIP but is the determinant for industrial, trading and service sector and consumer sectors. Age is only significant for property sector, while free cash flow is important factor for industrial, property and technology sectors. The second objective of this research serves several implications. Empirical evidences for the determinants of CWCFP reported only lagged CWCFP predominately affected the dependent variables for all sectors, while size is the second most factors that have important influence on all sectors except consumer. The other factors that are also important determinants are leverage, growth rate and free cash flow. However, their influences are only to certain sectors. Age plays no important role in the determinants of CWCFP. On the other hand, the determinants of AWCFP portray different results. Leverage is a very important determinant in all sectors in determining to employ an aggressive financing policy. Profitability and size are significant factors for industrial, trading and services and consumer sectors although their degrees of significant levels differ from one sector to another. Lastly free cash flow is not a relevant factor for only consumer sectors. The findings of the research have contributed to the dearth literature on determinants of conservative and aggressive WCIP and WCFP and indicate that pecking order theory, free cash flow hypothesis and agency theory could be used to explain those determinants. From the practical perspective, the adoption of different investment and financing policies are due to the different nature of business of respective sectors.

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CHAPTER ONE
INTRODUCTION

1.1 Research Background

Working capital is measured as the difference between current assets and current liabilities represents a company's operating liquidity. While working capital management (WCM) policy refers to how a company manage its current assets and current liabilities. Basically, the main elements of current assets are cash in hand; cash in bank, inventories, accounts receivable, prepayments and short-term marketable securities. Current assets are considered liquid as they can be converted into cash in a relatively short time (normally a year) and current liabilities consist of business obligations that are due within a year. Examples of current liabilities are accounts payable, short-term loan, accrued expenses and overdraft. Manager needs to make very pertinent WCM policy decision; that is how much investment (in current assets) to be made in its working capital and how should the working capital be financed (through current liabilities).

A company's working capital policy depends on two things: the level of current assets and the financing of current assets (Srivastava and Misra, 2008). An aggressive working capital policy is classified as company that keeps a low level of current assets and high level of short-term sources of financing. If a company has high level of current assets and low level of short-term financing but instead uses long-term sources for financing its current assets is said to be practising a conservative working capital policy. A moderate working capital policy is classified as company that maintains high (low) level of current assets and low (high) level of short-term sources of financing. Failing to optimize these two policies could lead to company facing with profitability, liquidity and efficiency problems. Dong and Su (2010) pointed out the survival of the companies depend on efficient WCM while Aktas, Croci & Petmetaz (2015) and Al-Shubiri (2011) found that efficient WCM led to greater firm performance. Awan, Shahid, Hassan and Ahmad (2014) concur with the former researchers and perceived optimal working capital decision is the "most important factor for maintaining liquidity, survival, solvency and profitability of a business".